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The Politics of Macroeconomic Policy Reform in South Africa

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THE POLITICS OF MACROECONOMIC POLICY REFORM IN SOUTH AFRICA

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1. INTRODUCTION

Macroeconomic policy poses a particular set of difficulties for those who would pursue the politics of economic reform. Interventions to achieve macroeconomic stabilisation focus in the first instance on shifts of macroeconomic prices, such as 'the' interest rate, 'the' exchange rate, the inflation rate and 'the' wage rate. The need to alter these prices (or their rates of change) is linked to a strong and coherent theoretical logic[1] and can be implemented through fairly straightforward administrative processes by those with authority over government finances. At the same time, however, such macro price reforms are something of a blunt instrument with uneven distributional consequences. They require skilled political management, the standard view being that the winners need access to their gains rapidly so that they can be mobilised to support the reforms politically, while the losers either need to be compensated or else neutralised politically.

These arguments underlie the predominant view of the political conditions for economic reform, summarised by John Williamson and Stephan Haggard in their synthesis of sixteen country case studies.[2] They suggest that the most important pre-requisites of successful reform are firstly a coherent economic team, and secondly a political leadership which is willing and able to insulate the team from political pressures, in other words, a party which possesses both "vision" (that is, the long-term perspective required to back the economic reform proposals notwithstanding possible short-term political costs) and a strong political base (that is, a party which is dominant). Specific economic circumstances (macroeconomic crisis) or political circumstances ('honeymoon' for a new government) can also help.

In other words, this approach advocates the *exclusion*, or at least restriction, of politics, for fear that demands from various groups in society will compromise policies based on sound economic analysis. Or, to be more generous, the politics required is that of 'selling' the economic policy after its formulation, that is, politically managing its implementation.[3] As Dani Rodrik has pointed out, the "fundamental fault line [in debates about the politics of economic reform] is the issue of how participatory reform politics ought to be. Most economists are on the side of speed, stealth and consequently reform from above."[4]

But it is now widely accepted that this form of centralised state action involving total autonomy from society) applies only to macroeconomic stabilisation, the *initiation* of the reform process. To sustain macroeconomic stability requires a second phase of reforms on both sectoral and

macro dimensions involving a markedly different process with far more complex administrative and institutional demands. The emphasis is on shifts in relative prices and in production structures, including public sector reform to reduce fiscal deficits through improved productivity in service delivery, improved tax collection and greater allocative efficiency in the budgetary process. This 'second stage of reform' also encompasses a wide range of state activities such as labour market regulation, competition policy, market regulation and so on. It is characterised by disparate and uneven processes involving significant decentralisation of authority, multiple theoretical and analytical bodies of knowledge and skills, and an interactive rather than insulated relationship between reformers and interest groups, since successful reform requires heavy flows of information and active co-operation and negotiation. Political management in other words is not concerned with mediating between winners and losers, but with adjustment and flexibility.[5]

It is somewhat paradoxical that the institutional and political approach seen to be necessary for the first steps in reform may well be entirely *in*appropriate for the subsequent process aimed at the sustainability of reform. A second paradox emerges from the view that macroeconomic stabilisation is best initiated by a team, or rather, an insulated politician backed by a technical team, with a high level of discretionary power. Yet the weight of macroeconomic theory in the 1990s suggests that 'rule-based' policies are most likely to produce sustained macroeconomic stability, by preventing politicians within a democracy adopting destabilising (that is, excessively expansionary) macro policies in the effort to win voter support. But since reform requires a high level of political will, it raises the question of whether the 'rules' and constraints to be implemented to sustain the course once it has been corrected, should continue to rely on the political will of 'far-sighted' individual or teams of policymakers, or whether (and how) they should be institutionalised and de-personalised.

The view of politics implicit in the Washington consensus has worrying implications for democracy and its consolidation, at least for those versions of democracy which incorporate a dimension of pluralism. Critics of the 'benevolent dictatorship' view argue that the necessary centralisation and unity of purpose required for the state to direct reforms can be achieved by actively engaging in a political process with the aim of constructing consensus, or at lest negotiated agreement, amongst interest groups in relation to economic policy reforms. This will be more likely to contribute not only to democratic consolidation, but also to the sustainability of the reforms themselves.[6] If political interests do not allow themselves to be excluded, that is, if the process does *not* mimic a benevolent dictatorship, then government could be forced by

political pressures to abandon the reforms, or amend them, with possibly greater damage to investor confidence than if the reforms had not been adopted in the first place.[7]

Given the weakness of the state characteristic of many societies which have recently made the transition to democracy, there may be no 'choice' available in resolving this paradox - political and institutional circumstances may impose a particular pattern of centralised state action, which may turn out to hamper democratic consolidation (as well as not be effective in introducing and protecting macroeconomic policy reform). Thus the paradoxes identified above offer little comfort to critics of the 'Washington consensus' approach. They cannot ignore the force of the 'rules' perspective and accept full discretion in macroeconomic policy, if only because of the impact on investor credibility and confidence of doing so. This poses the problem of reconciling 'rules' and the democratic process.

This paper examines SA's macro reforms and their relation to growth strategy, in the light of the debates and paradoxes identified above. I suggest that South Africa has not implemented macroeconomic reforms in a way which combines macro stability effectively with democratic consolidation. My starting point is that *macroeconomic* policy reform in South Africa was initiated in 1989 with the objective of stabilising inflation, though not explicitly as part of a comprehensive reform programme or growth strategy. Since then, macroeconomic reform has proceeded along an uneven non-linear path. While monetary and exchange rate policy have maintained a consistently austere approach and have been successful at least in lowering inflation, fiscal policy reform was erratic and sporadic until 1993, when serious attention to the fiscal aggregates began. The inauguration of the Interim Constitution in 1994 forced a greater focus upon fiscal processes, because of the requirement for a new system of intergovernmental relations.[8] Understandably, given the transition, growth strategy has been extremely unsettled. Three distinct frameworks - the NEM, RDP and GEAR - followed each other in fairly quick succession between March 1993 and June 1996. GEAR placed macroeconomic austerity at its centre and further emphasised outward orientation and a reconfigured relation between the private and public sectors, so that in a sense it completed, or at least signalled the intention to complete, the policy reform process initiated 7 years earlier.

Section 2 examines the first round of macroeconomic reforms between 1989 and 1993. In section 3 , I look at the manner in which 'insulation' of economic reform was managed during this period, when tripartism emerged out of macroeconomic policy reform. Section 4 discusses the ANC's commitment to the reforms which had preceded the establishment of the

Government of National Unity. Section 5 looks at the GEAR (Growth, Employment and Redistribution) strategy announced in June 1996. Section 6 concludes.

2. MACROECONOMIC POLICY REFORMS 1989-93

As with many other countries, the 1970s and 1980s had been characterised in SA by lower growth and higher inflation. GDP growth dropped from 5.5% per annum in the 1960s to 3.3% in the 1970s to 1.2% in the 1980s. From 1974 to 1989, the consumer price index in South Africa rose on average 13.6% per annum, and never dropped below ten percent.[9] SA was evidently a moderate inflation economy[10] in which expectations had adjusted to an annual inflation rate in the 10-20% range, and there was considerable inertia in the process.

Through the 1970s and 1980s, there had been much rhetoric but little action amongst SA policymakers about the costs of inflation and its threat to growth. Monetary and fiscal policy had been subordinate to political concerns, as two anecdotal examples suffice to illustrate. In 1984, the ruling National Party faced possible defeat by the extremist Conservative Party (which had broken away from the NP in 1982) in a by-election in a white working class constituency near Johannesburg. Although macroeconomic circumstances required no change in interest rates, the government prevailed on the then Governor, Gerhard de Kock, to lower rates. The by-election duly being won by the government, the RB once again increased interest rates.[11] Similarly for fiscal policy: "in March 1988, as part of a great PR campaign against inflation, [then President] PW Botha pledged to hold public servants salaries static for a year. A rise was announced 6 months later." (*Financial Mail*, October 20 1989)

Exchange rate policy during the 1980s until 1988 was oriented mainly towards offsetting the impact of changes in the dollar gold price and stabilising the real rand price of SA's main export earner and other primary commodities. This resulted in a fluctuating nominal exchange rate, but overall depreciation.[12] When 'financial sanctions' were imposed on SA in August 1985, as international creditors recalled outstanding loans, the exchange rate depreciated further. The need to run current account surpluses to finance the capital outflows for the purpose of debt repayments affirmed existing exchange rate policy, and the rate of inflation was allowed to tick upwards. By 1988, growth was beginning to improve and adjustment to the debt crisis seen as complete.

Macro policy attention now shifted to inflation which declined in 1987, but was nonetheless considerably higher than SA's major trading partners. This was seen to be a problem, given the debt repayment situation and the medium-term need for a current account surplus. In 1988, monetary policy was tightened (the benchmark bank rate rose by 5 percentage points) and the Reserve Bank switched its focus to stability of the real exchange rate rather than the real gold price.

The tighter policy did not seem to be effective as money supply growth accelerated in 1988 and inflation began to rise again in early 1989, reaching a high of 15.7% (year-on-year) in June 1989, with the quarter-to-quarter rate doubling from 9.2% in 1988:1 to 18.4% in 1989:2.[13] Though arguably less of a problem than the three- or four-digit inflation rates which precipitated reform elsewhere, this was regarded as sufficiently serious to warrant a fundamental shift in orientation, which occurred when Chris Stals was appointed Governor of the SA Reserve Bank in August 1989. In his Governor's Address to the Bank's Annual Meeting a few weeks after his appointment (possibly the most important occasion of the year), he announced that "the main emphasis of monetary policy has been switched to the curtailment of inflation". It soon became apparent that "the goal of the Bank's efforts had been narrowed to that of maintaining the value of the currency"[14], that is, lowering inflation and maintaining a relatively stable nominal exchange rate. This, the Bank argued, was "the best contribution it [was] capable of making to long-term real economic growth".[15] An interesting reflection on the Reserve Bank's poor credibility at the time was that the rate rise in October 1989 was seen to take the financial markets by surprise, despite several warnings by Stals that he planned to take the action.

It is worth noting though that the Bank's time horizon for lowering inflation to the level of SA's trading partners was 4-5 years, and also that an important factor in the initiation of the new approach was that favourable prospects for maintaining a current account surplus enabled the downward pressure on the rand to be eased. It was felt that a more stable rand would squeeze profit margins forcing wage cuts (or lower increases) and easing cost pressures, so that exchange rate policy would support monetary policy.[16] Interestingly, this argument was advanced at the same time that government and the trade unions were engaged in a major confrontation over the Labour Relations Amendment Act, where government intentions were clearly to restructure the wage bargaining process to facilitate downward pressure on wages.

It appears that there was a co-ordinated view favouring reform within government at the time, an 'informal committee' involving the key economic policymakers in the state having been initiated by Stals in 1989 (*Finance* Week, July 16 1992) This co-ordinated view included a commitment to fiscal adjustment, even though the deficit in 1989 was well below the medium-term 'guideline' of 3%. Fiscal reform thus focussed at the outset on re-prioritising spending, together with reducing the tax burden. The decision, made in 1990 on the advice of the IMF, to replace the GST with VAT during 1991 was an element of the latter, together (curiously) with lowered import surcharges and rates on dividend and interest income. Individuals' tax rates were further adjusted to eliminate the impact of fiscal drag, presumably in anticipation of lower inflation.

These reforms did not amount to a comprehensive or coherent programme, nor were they announced as such. Nonetheless, it was evident that at least at the outset there was a coherent reform 'team' in place. By embarking on a macroeconomic reform programme with a medium-term perspective on success, at more or less the same moment that it was also initiating the 'normalisation' of political life through its release of prisoners and unbanning of organisations, the government was demonstrating its confidence in its capacity to manage a political transition and retain power. This confidence was fundamentally misplaced. But the government's efforts to manage the macroeconomic reform programme politically nonetheless had a significant impact on the transitional process, while the reforms' *economic* legacy persists.

The direct consequences of the reforms are reflected in the data for 1989-93 presented in Table 1. Interest rates were raised through 1989 and 1990, before beginning to drop in 1991. Although the rand's nominal effective rate continue to depreciate, up until 1993 it was doing so at a much slower rate than before. As the Reserve Bank had predicted, two decades of double digit inflation had resulted in well-established expectations and a high level of inertial inflation. The CPI actually increased in 1991, and it took nearly four years of contractionary policies before the rate dropped to single digits. In the meantime, demand compression was reflected in a rapidly dropping investment rate, and negative GDP growth rates from 1990 through 1992. This had predictable effects on employment, which also shrank.

3. THE WEAK STATE: INSULATION AND TRIPARTISM

Table 1 also shows that up until 1993, fiscal policy provided only limited support for the monetary authorities. Indeed, in 1992 and 1993, the deficit really ballooned upwards, producing a rise in government debt and thus higher levels of debt service commitments in the years since. These differential outcomes for monetary and fiscal policy were closely related to the relative ability of the respective policymakers to be insulated from political and social pressures. There was a marked difference between the Reserve Bank and the Department of Finance in this respect, related to institutional location together with a weak executive in the context of the political transition process. Notwithstanding the National Party's own assessment of its capacity, it was a weak governing party without political dominance, with a fragile base and inevitably with a short-term perspective, given the transitional situation and its tenuous hold on power.

While this enabled the Bank to be *more* insulated, it meant that the Finance Department was *less* so, and more subject to pressures. The Reserve Bank Governor was not a member of the cabinet, and the Bank used the opportunity of a weak executive to increase its relative strength within the state. From the time of Stals' accession, the Bank promoted greater independence for itself, on the basis of arguments which used the model of the German Bundesbank to make the link between increased central bank independence and lower inflation.[17]

Stals' himself commented on this a year after his appointment: "I have yet to be approached by politicians with any unreasonable demands for premature easing of monetary policy" and gave two explanations: "First, SA's political system is in transition. It resembles the second term of the US presidency [*sic*] when the Fed also tends to enjoy less political interference. Secondly, the international debate over the independence of central banks". (*Finance Week*, August 9 1990) Of course, one important difference between the South African transition and the second term of a US president is that the institutions of the state, and the Constitution, are not in substantial flux in the latter case. The Reserve Bank was able to extend the debate about its independence into the constitutional negotiations, and the outcome was a clause[18] in the new Constitution securing its independence from government. It would appear that the Bundesbank continued to be the prototype for this clause, which is quite vague in specifying the content and limits of this independence, as well as the nature of the accountability of the bank and its Governor. The 'international debate' to which Stals refers in fact regards the Bundesbank model with some ambivalence: Stanley Fischer, Deputy MD of the IMF, refers to "the German model making the Bundesbank accountable to the public" and suggests that while this "approach may work, nonetheless, precise accountability to elected officials is more likely to be

effective than vague general accountability."[19] And Wolfgang Streeck refers to the Bundesbank as a 'semi-sovereign state' which "considers its [pre-announced] monetary target to be non-negotiable, with the federal government or anybody else. ... it is precisely the policy's credibly established non-negotiability - and the implied rejection of any trade-off with other objectives, in particular full employment - which is regarded by the bank as its most important condition of success."[20]

Given the importance of the 'big business' constituency to FW de Klerk, and their support for Reserve Bank policy as well as its shift to a more independent stance[21], it would probably have been impossible for de Klerk to impose a different policy on Stals, despite the economic contraction which clearly affected the National Party's support. But it is also true that there was less public pressure on monetary policy than on fiscal policy, despite the evidently greater impact of the former on the disastrous output and employment performance of the economy at the time. There was no public campaign against high interest rates in the early 1990s, for example: was this perhaps because the high rates didn't hit the poor directly as they were not direct borrowers from the banks?

The Department of Finance on the other hand was unable to resist mounting pressures for higher spending. These were linked to several aspects of the transition: the declining ability of the state to exclude blacks from the rights of citizenship led to demands for racial equality of pensions and other measures for poverty alleviation; the National Party's concern to consolidate and expand its political base was reflected in higher civil service salaries; and the difficulties of establishing 'normal' political life led to rapid increases in police spending, offsetting any savings in the military budget resulting from the suspension of 'official' armed struggle. The treasury's inability to control the fiscal aggregates was already evident in the 1990/91 Budget, notwithstanding the establishment of an extra-budgetary fund in the form of the Independent Development Trust.[22] The appointment of a non-politician, Derek Keys, as Minister of Finance in June 1992 promised more than could be achieved in terms of fiscal deficit reduction, as the 1993 data in Table 1 reflect.

The differential degree of insulation between the two key institutions responsible for macroeconomic policy fractured the coherence of the economic team. By mid-1991, the Department of Finance and the Reserve Bank were publicly bickering over each other's policies - the bank complaining about the growing fiscal deficit, and the Department responding that the reason for this was real interest rates that were unnecessarily high. (*Business Day*,

August 7 1991; *Finance Week*, June 20 1991) Incoherence in the policy team continued to bedevil reform initiatives up to the transitional election in 1994. Most revealing of this was the release by two government agencies of only partially consistent documents presenting a "Normative Economic Model" in early 1993.[23]

The inability of government to insulate the Department of Finance not only resulted in the growth in the deficit, but also contributed to the emergence of tripartite structures in economic policy, with the establishment of the National Economic Forum in October 1992 in the wake of the conflict over the introduction of VAT. Government announced in 1990 its intention to switch to VAT from GST and at the same time eliminate the zero tax rating of a wide range of basic foods.[24] This led to a mass public campaign led by a very broad coalition dominated by COSATU, but including support even from consumer bodies and welfare organisations primarily serving the white population. The coalition succeeded in forcing the government to introduce VAT at a lower rate than initially planned, thereby significantly affecting the size of the deficit in 1991/2.

The anti-VAT campaign was seen by the trade unions as having a broader objective: it was "also a demand for a macroeconomic negotiating forum".[25] In making this demand, explicit parallels were drawn with both the NMC, the statutory tripartite labour market regulator which the unions had joined in 1990, and with the ongoing political negotiations in CODESA. Though government resented the pressure, de Klerk complaining that the trade unions were attempting to "introduce interim government by stealth"[26], it was unable to resist the demands, especially when business joined the unions in the call. The government's acceptance of the NEF was facilitated by Derek Keys, the businessman turned Cabinet Minister, and thus arguably more comfortable engaging with popular organisations than a regular National Party politician.

While the establishment of tripartism was self-evidently a watershed in the politics of economic policy formulation in South Africa, it is again noteworthy that the union-led campaign for the NEF was characterised by a curious lack of engagement with macroeconomic policy narrowly defined, and in particular with the day-to-day orientation at the time of monetary and exchange rate policy.[27] Instead the focus of criticism over political prerogative and systemic change was firmly on 'long-term' economic restructuring, such as the reform of indirect taxation. This pattern might be explained by the conjunction of the establishment of tripartism and the constitutional negotiations which of course focussed specifically on such longer-term and structural issues.

Perhaps because of this feature of its origins, *negotiations* over (narrowly-defined) macroeconomic policy has not really become established as part of tripartism in South Africa. None of the NEF agreements are concerned with these issues. The discussion which was closest to macroeconomic concerns, the debate over the Normative Economic Model, was 'buried' in a technical committee of the Long-term Working Group, itself very much the junior of the two Working Groups. Macroeconomic policy discussion has of course taken place. In an early example, Keys "reportedly made a presentation to the [NEF] ...in November 1992 on the worsening budgetary situation, and largely convinced parties that 1993/94 could not be a year for substantial fiscal stimulus."[28]

This has been the pattern: rather than focussing on reaching agreement, as has been the case for discussion of policy in other areas (labour markets, trade and industrial issues), macroeconomic policy discussion within the tripartite context has involved the government sharing information to win support for its own position and stance, rather than negotiating a position and explicitly making trade-offs with the 'social partners'. In a sense this has assisted the process of insulation of macro policymakers: they are able to assess likely reactions to proposals, but retain much greater autonomy to decide whether to adjust them in light of the reactions, than if a negotiated agreement were the objective. The approach to other issues has been characterised by joint formulation and even implementation of policy: as far as the NEF is concerned, in the 1993/94 Budget, allocations were made to the NEF and the National Housing Forum to implement projects, while the Forum's role in formulating the GATT offer is discussed elsewhere.[29]

With the establishment of NEDLAC as successor to the NEF in 1994, Budget proposals have continued to be presented to NEDLAC's Public Finance and Monetary Policy Chamber. "The consideration of the 1996-97 Budget followed a *unique* approach as compared to the general agreement-making function of NEDLAC. The parties to the Chamber characterised the discussion as an exchange of information and views, ... while acknowledging that the Ministry of Finance remains solely responsible for the Budget and how it is presented."[30]

4. THE ANC AND MACROECONOMIC REFORM

When it took office as the dominant partner in the GNU, the ANC inherited an economy that had been stabilised, with inflation down to 9.7% in 1993, and growth picking up from the second half of 1993, after four years of recession. The capital account of the balance of payments turned around in the wake of the first democratic election as inflows were positive for the first time since the 1985 debt crisis. South Africa quickly joined the ranks of "emerging markets", a perhaps dubious privilege given the volatility of international capital flows, as SA would discover two years later. The ANC could be regarded as fortunate perhaps that stabilisation of the price level had been undertaken *prior* to the election, so that it did not have to manage the political consequences of falling output and especially employment (assuming that the inflation rate did indeed have to be brought down through austere monetary policy). On the other hand the macroeconomic reforms which had been carried out prior to 1994 meant that the ANC's hands were effectively tied - the reforms had "created a new largely irreversible reality that [the] successors dared not touch"[31] for fear of losing credibility and destroying private sector confidence.

However the ANC had already shown an understanding of the issue of credibility and had furthermore accepted that it was necessary for private sector investment to lead the growth process, and that this investment would be forthcoming only in an environment characterised by fiscal discipline. Speaking in late 1991, President Mandela had indicated

> the SA economy is in decline. Measures must be taken to ensure that it grows. These must include a sharp rise in the rate of investment, the growth of the domestic market, the growth of exports of manufactured goods, the raising of skill levels to increase labour productivity... redistribution of wealth ....and the creation of opportunities including through affirmative action to ensure black empowerment. .... the private sector must and will play the central and decisive role in the struggle to achieve many of these objectives...let me assure you that the ANC is not an enemy of private enterprise...we are aware that the investor will not invest unless he or she is assured of the security of their investment...The rates of economic growth we seek cannot be achieved without important inflows of foreign capital. We are determined to create the necessary climate which the foreign investor will find attractive.[32]

Mandela's sentiments were further confirmed by the acceptance of the clause in the 1993 Interim Constitution relating to the independence of the Reserve Bank. This implied at the same time that Chris Stals would continue to be Governor: there was little purpose from the point of

view of credibility in accepting the clause and then replacing him with (to investors) an unknown quantity. In any event, the clause itself made little difference to the operation of the Bank and monetary policy, since it was sufficiently vague that the relation between government and the Bank would continue to depend *de facto* on the personal styles and relationship of the Governor and the Finance Minister.

We will return to this point below. But it is worth noting that there was division within the ANC on the 'independent central bank' clause[33], though the issue was not thoroughly aired, even amongst ANC economists, before the position of the leadership (in favour of the clause) was adopted in the negotiations. And ANC support for this position was reiterated by President Mandela just before the elections: "We argued for the independence of the [Reserve] Bank when this issue was discussed at the constitutional negotiations. We did so not only because we are committed to the sound economic management of the country, but also because we want to send out a strong signal to the international and local business and financial communities that we are serious about this commitment."[34]

This difference of view, and its resolution, was interesting in presaging later more intensive debate within the party over the GEAR strategy, when the leadership similarly managed the process to secure their vision, that is, the reforms.

The re-appointment of Derek Keys as GNU Finance Minister in 1994 (and a few months later his successor Chris Liebenberg, like Keys a businessman rather than politician) was similarly intended to demonstrate the ANC's acceptance of the macroeconomic reforms carried out in the last few years of apartheid rule. But even prior to the election, the ANC had negotiated jointly with Keys and the outgoing government, a loan agreement with the IMF for $850 million.[35] The agreement was eventually concluded in November 1993 during the period of (official) interim government and was thus signed by the Transitional Executive Council of which the ANC was of course a part. The "Statement of Economic Policies" which was attached to the loan agreement strongly affirmed a continuation of the existing macroeconomic stance:

> an easing of monetary policy would have risked a further undermining of confidence and a resurgence of inflation ... the thrust of SA's monetary policy during the past year will be maintained.....despite the pressures for additional expenditure that will arise in transition, there is widespread understanding that increases in the government deficit would jeopardise the economic future of the country.....Given the importance of

> maintaining a competitive tax structure. It [fiscal policy] will emphasise expenditure containment rather than raising taxes.[36]

It was theoretically possible that the ANC could have chosen to renege on these policy commitments after the finance had been made available (as has occurred elsewhere). But to renege on such a commitment could have had very high costs, not only economically but also politically, where it might have precipitated pre-emptive action by various 'reluctantly democratic' groupings. On the economic side, the new government would have been sharply reminded of the possible costs by the collapse of the (net) forex reserves during the first half of 1994, before the switch in capital flows.[37] In addition, there was a rise in government bond yields in September 1994.[38] Thus the ANC was clearly committed to (if not unified in) support for the macro reforms introduced prior to the election. This is worth underlining not to suggest that this position was incorrect - as noted, the ANC "dared not touch" the reforms - but rather to emphasise the *consistency* in the ANC's position on macro policy between 1993 and 1996, or between the RDP and GEAR. GEAR in other words did not represent the abandonment of the RDP or a rightward shift, as many have suggested.[39]

This understanding is borne out by an examination of the RDP itself, that is, of the structures put in place to implement the RDP. Thus the RDP Fund[40] was set up within the parameters of the announced government target of keeping its consumption expenditure constant in real terms: the approach was to 'leverage' a reprioritisation of expenditure by cutting line departments' budgets and forcing them to re-apply for the funds to spend on "RDP-oriented" projects, rather than increasing total spending to make room for these projects. The point here is not that this was a rather clumsy approach to re-prioritisation, as many commentators have noted.[41] What is important rather for our purposes is that the approach to the RDP Fund rested upon fiscal discipline. And relevant ANC cabinet ministers reiterated their commitment: as Alec Erwin put it in October 1994: "The strict adherence to fiscal discipline is designed to achieve critical transformatory objectives [in the RDP]...The purpose of fiscal discipline is in the first instance to bring about a reprioritisation of state expenditure, an improvement in certain macroeconomic relationships and by these means to place the public sector in a better position to manoeuvre the economy in a manner that promotes equitable growth."[42]

Furthermore, the RDP Office was set up within the executive in a way that allowed it very restricted influence over fiscal policy, and no influence over monetary issues or other aspects of macro policy. In other words, macro policymakers were effectively insulated from the RDP and

especially from those social groups whose (justifiable) demands for improved access to public goods and services might have overwhelmed well-intentioned political leaders.

5. THE GEAR STRATEGY

The starting point for GEAR was the increasingly held view that the RDP and its associated programmes were not going to be sufficient to increase growth and job creation from the improved but still disappointing performance of the SA economy. The *micro*economic programmes and policies assembled under the RDP label, covering small and medium sized enterprises (SMMEs), public works projects, land reform and infrastructure development, were working, to be sure, but too slowly to have any significant medium term impact. What was needed in addition, it was felt, was a *macro*economic intervention to accelerate the process. Fiscal expansion was ruled out from the start, given the commitment to maintain control over the fiscal aggregates, of course, but there was general agreement that the rand had become significantly overvalued. This was despite the fact that the Reserve Bank had shifted in 1992 to a policy of maintaining as far as possible relative stability in the *real* exchange rate.[43] Substantial capital inflows during 1995 (see table 1) had slowed the depreciation of the nominal rate relative to the inflation differential.

Key policymakers had therefore decided an exchange rate devaluation was necessary *before* the rand's initial drop in February 1996, though there was little certainty about how to manage this either technically or politically.[44] A devaluation was of course a standard piece of the 'Washington consensus' package but so was a stable nominal rate under circumstances where inflation was seen to be the more pressing problem. Notwithstanding its own (apparent) policy, selling a devaluation to the Reserve Bank might not be easy, given the risks of the exchange rate adjustment sparking inflation, which would also neutralise the impact of the policy by eroding any temporary competitive improvement.

As it turned out, "selling" a devaluation proved unnecessary - the financial markets decided for themselves that the rand was overvalued and the nominal effective rate dropped by 18.1% between January and July 1996.[45] The policy focus shifted to restoring credibility amongst investors, particularly financial investors, with the purpose of stemming the currency's decline and especially the associated switch in capital flows: net capital inflows of R11.2 billion in the

second half of 1995 dropped to inflows of R2.7 billion in the first half of 1996. With the drop in the reserves, following the earlier drop in 1994, something of a sense of crisis emerged.

With the planned policy intervention no longer necessary, there was no *action* around which to structure the policy framework, so that the publication of the strategy document itself in June 1996 became the focus. Rather than introducing a more innovative strategy, this document was essentially a re-affirmation of the commitment to macroeconomic austerity, that is to the reforms which had already been carried out, together with an assembling of policy measures in other spheres that government was planning or already actively implementing.

Thus GEAR's fiscal policy reduced the existing deficit targets (spelled out by Finance Minister Keys in 1994) by 0.5% of GDP per annum: the target was now 4.5% in 1996/97, dropping to 3.0% by 1999/2000, while also specifying a ceiling on the share of GDP taken by tax revenue of 25%. Thus government's total resource envelope was determined. Monetary policy identified both lowered inflation and a stable real effective exchange rate as objectives, but with no specifics about inflation targets or how possible tradeoffs between the two might be managed. GEAR also reiterated government plans to introduce 'phase II'[46] reforms to enhance the sustainability of the macro reforms. These include increasing efficiency in revenue collection and financial management, and budget reforms to improve expenditure planning and control, and to re-prioritise spending.

Aside from its macroeconomic dimensions, GEAR also re-affirmed government commitment to enhanced international competitiveness in a more open economy. Tariffs would be reduced faster than the commitment to the World Trade Organisation (WTO); production costs lowered by flexible application of employment standards and labour cost adjustments; the forex market liberalised in a gradual process; and investment tax incentives introduced to encourage investment in internationally competitive and labour-absorbing projects, and to boost SMMEs. Finally, GEAR re-iterated the 'microeconomic' policies which were already being implemented but whose effects had been adjudged too slow. These included privatisation, social infrastructure investment, SMME support and land reform.

The immediate aim of the GEAR strategy was to signal to potential investors the government's (and specifically the *ANC's*) commitment to the prevailing orthodoxy. In "marketing" the strategy, senior Department of Finance officials made explicit its close parallels with the approach of the international financial institutions, while emphasising at the same time the idea

that GEAR was "home-grown" in SA.[47] The hope was that this would lead to increased investment sufficient to attain the specified targets of a GDP growth rate of 6% per annum and 400 000 new jobs per annum by the year 2000.

An essential difficulty with the strategy adopted in GEAR quickly became evident. To improve its credibility, a government needs to make a *costly* commitment to its policy stance. The South African government did not immediately undertake any action to implement GEAR, other than the announcement itself of the strategy. Nor does GEAR incorporate any sanctions or other costs to the political leaders, should the commitments (and targets) not be met. Thus there was no cost associated with the government expressing commitment to its policy stance, and for this reason it was not immediately seen to be credible. This accounts for the slow and cautious response by investors to GEAR. It was only when the government began to undertake specific actions late in 1996 and early in 1997 - providing persuasive evidence prior to the Budget that it would meet its deficit target for the year, announcing the partial privatisation of Telkom, announcing in the Budget speech the further liberalisation of exchange controls - that capital inflows (both portfolio and direct) began to pick up. During the first three quarters of 1997, capital inflows not related to changes in the reserves rose from the 1996 level of 0.7% of GDP, to 4.2%. In the second quarter, the figure was 8.7% of (quarterly) GDP. Not surprisingly, the 'little bang' of exchange control liberalisation in July 1997 turned out to be hardly a whisper.

But whereas the government could validly claim that financial investors, domestic and international, were persuaded (for the moment?) of the credibility of the policy stance, the same could not necessarily be said of investors in productive capacity: gross domestic fixed investment picked up only marginally to 17.3% for the first two quarters of 1997 (1996: 17.2%), before sliding to 16.9% during the third quarter. GDP growth for 1997 was expected to be only between 1.5% and 2%, well off both the 1996 figure (3.1%) and GEAR target for 1997 (2.9%). It appears that building a reputation which can convince investors considering longer-term commitments is a slower and more complex process than persuading the financial markets of one's case.

Close affinity with the 'Washington consensus' characterised not only the substantive policy recommendations of GEAR, but also the process through which it was formulated and presented publicly. In fact, the GEAR strategy was almost a textbook case of the conventional wisdom in the politics of economic reform. It was drawn up in somewhat secretive conditions by a small team of economists, in the context of a currency crisis which was dramatic by SA

standards, if not in global terms. The document was published after only the most cursory consultation within the ANC, with its allies in the trade unions and the Communist Party, or with interest groups in society, and Finance Ministry officials stressed their unwillingness to subsequently negotiate any element of the strategy. This was 'reform from above' with a vengeance, taking to an extreme the arguments in favour of insulation and autonomy of policymakers from popular pressures. This stance served of course to increase the temperature of the debate between the ANC leadership and popular groups and organisations within its political base, a debate which has focussed on process at some cost to the consideration of substance.

The political leadership has basically relied upon party loyalty and discipline together with its own leadership skills to secure support for, or at least compliance with, the GEAR strategy. After 18 months of often tense and difficult debate, which occasionally broke out into the public arena, they finally established a firm position within their own party, reflected in the endorsement of the current economic policy stance at the ANC's December 1997 conference. The use of the internal processes of a political party to insulate state authorities from opposition to policy reforms does not appear to have been common in comparative experiences, where the interaction between the ruling party and opposition parties is more often the focus, and the capacity of leaderships to maintain control over members assumed.[48]

On the one hand, that a position which started out as extremely unpopular has now won full organisational support, is a tribute to the leadership skills deployed by the ANC. On the other hand, it remains something of a puzzle as to why the strategy of refusing to engage in public debate over the GEAR strategy was adopted, and what was gained from this stance and from using party loyalty and discipline to enforce it. It can be noted that it was the lack of immediate policy *action* within GEAR which enabled such approach to insulation to be followed, since almost any intervention would have had to be publicly discussed and in some form negotiated with affected groups. While this absence of action did enable the government to avoid consultation, it is not clear, as noted earlier, that it enhanced credibility with investors and thereby contributed to the success of the strategy. Furthermore, when actions were taken later which contributed to GEAR's credibility, such as the Telkom privatisation, they were indeed more widely canvassed, though they were not specifically presented as elements of GEAR.

The irony is that if a devaluation of the rand had been necessary, as was originally envisaged, negotiation would have been required with the very groups who were later most unhappy with their exclusion from consultation, namely the trade unions. In fact the economic logic of a devaluation suggested that it would have been necessary not only to persuade the Reserve Bank to loosen monetary policy, but also to try to put in place an incomes policy to mitigate the possible inflationary consequences. The survival of a chapter on a "national social agreement" in the published version of GEAR was a vestige of this thinking. But the market-led depreciation allowed, indeed required, a tightening of monetary policy through the course of 1996, which in turn helped to keep inflation down and made incomes policy no more than marginal to the overall thrust of GEAR, even at the time of publication. Nonetheless, that an incomes policy was even contemplated, which would have required complex negotiations and difficult tradeoffs (with business as well as labour), makes it harder to understand why the choice was made to eschew a broader process.

One possible explanation for the tactics used to insulate GEAR is linked to the view that the state is 'infrastructurally weak' as a result of the nature of the transitional process, that is, the state has limited ability to make policy decisions ands implement them by "making alliances, subordinating vested interests...*and* gaining popular acceptance for its proposed solutions."[49] Even though the state has the institutional resources, in the form of NEDLAC, to engage in a consensus- or agreement-oriented process involving consultation with interest groups, NEDLAC had perhaps not yet shown itself able to deal effectively and quickly with processes which promised to be difficult and involve tough trade-offs. As noted earlier, *negotiation* over macroeconomic policies has not been a feature of NEDLAC nor of its predecessor, the NEF. Given the sense of crisis which permeated the formulation of GEAR, the government was perhaps not prepared to take the risk of impasse or breakdown of a tripartite process. Instead it preferred to insulate its policy programme by relying upon its 'despotic power', that is, the ability to govern while remaining entirely autonomous of society, some degree of which is retained even by a relatively weak state.

6. CONCLUSION

Even if the ANC conference decision - to broadly endorse the government' economic policy - leads to more debate in future (in NEDLAC or elsewhere) over the detail of GEAR, it seems unlikely that GEAR itself would be amended, as opposed to an entirely new policy framework being constructed. The integrity of GEAR itself has been maintained by means of the

executive's strategy of firmly protecting its autonomy. It is even possible that the 'resolution' of the conflict over the strategy which was accomplished at the ANC's December conference might produce an improvement in the programme's credibility and a positive impact on fixed investment.

The implications of the methods used to manage the politics of macroeconomic reform remain of concern, however. South African monetary and fiscal policy is leaning towards adopting for the long haul what might be labelled the "German" model of macroeconomic policy institutions. As noted earlier, this involves the setting of targets by macro policymakers themselves, the insistence on the non-negotiability of these targets, and only vague and general accountability 'to the public'. This model essentially relies on 'leaders with vision and determination' to determine the appropriate policy stance. In other words, policy depends on the individual styles of the incumbents, rather than on institutional mechanisms. The content of the constitutional clauses dealing with the central bank's independence, the politics of GEAR's implementation, the Reserve Bank Governor's recent rejection of calls for more open discussion of monetary policy[50], the 'special status of macroeconomic policy debate within NEDLAC, all strongly reflect German-type arrangements.

It is true of course that the Bundesbank has an enviable record amongst policy institutions for meeting its objectives. However, the Bundesbank has a long-established reputation and is part of an extremely powerful state within a consolidated democracy. The South African state, and South African democracy, are rather more fragile. South Africa may have more to gain from a different approach to institutionalising sustainable macroeconomic policies, what might be called the "New Zealand" model. This weighs much more heavily the need for consultation, accountability and decentralisation in the formulation and implementation of 'rule-based' policies. It allows for greater flexibility in response to exogenous shocks, which seems crucial as long as global capital flows continue to be as substantial and as volatile as at they presently are. Perhaps most important, this approach seems to offer more promise in terms of enabling a self-reinforcing combination of macroeconomic policy reform and democratic consolidation, that is a democratic and participative process to devise 'rules', to which policymakers can commit, together with mechanisms of accountability for executive performance in adhering to the rules.

TABLE 1: BASIC MACROECONOMIC DATA

		1988	1989	1990	1991	1992	1993	1994	1995	1996
1.	Real GDP growth[1]	4.2	2.4	-0.3	-1.0	-2.2	1.3	2.7	3.4	3.1
2.	Investment Rate[2]	19.8	20.6	19.6	17.8	16.6	15.5	16.1	16.9	17.2
3.	Budget deficit[2,3] (National government)	4.4	4.3	3.2	4.9	9.3	10.1	5.7	5.7	5.4
4.	Primary surplus[2,3] (National government)	0.7	0.2	-0.8	0.5	4.4	4.9	0.1	-0.1	-1.1
5.	PSBR[2,3]	4.0	2.1	4.5	5.4	9.6	10.4	6.0	6.1	5.9
6.	Current account[2] (- deficit)	1.7	1.4	1.9	2.0	1.5	1.6	-0.3	-2.1	-1.6
7.	Capital flows[2,4] (+ net inflow)	-3.2	-1.4	-0.6	-0.7	-1.4	-4.0	1.0	4.0	0.7
8.	Change in net reserves[2]	-1.5	0.0	1.3	1.3	0.1	-2.4	0.7	1.9	-0.9
9.	Weeks of import cover (at year-end)	6.1	5.5	5.6	7.2	7.6	6.5	6.8	7.0	5.6
10.	Nominal effective exchange rate (1990=100)	114.7	103.3	100.0	94.0	89.5	81.2	73.7	69.5	60.5
11.	Real effective exchange rate (1990=100)	95.8	95.4	100.0	103.0	104.8	100.2	97.1	97.4	89.4
12	Gold Price (US$, 1990=100)	114.0	99.5	100.0	94.4	89.6	93.8	100.1	100.2	101.1
13.	Bank rate (average for year)	11.8	16.8	18.0	17.2	15.4	12.9	12.3	15.3	15.8
14.	Inflation[1] (CPI)	12.9	14.7	14.4	15.3	13.9	9.7	9.0	8.7	7.4
15.	Real interest rate	-1.1	2.1	3.6	1.9	1.5	3.2	3.3	6.6	8.4
16.	M3[1]	27.3	22.3	12.0	12.3	8.0	7.0	15.7	15.2	13.6
17.	Employment[1] (formal sector)	1.9	0.8	-0.3	-1.8	-2.0	-2.1	-0.6	0.7	-1.1
18.	Average real wages[1] (private sector)	2.7	-0.6	0.0	0.7	1.5	0.1	1.4	2.5	1.8

NOTES:

1. Percentage change
2. Share of GDP
3. Fiscal years: 1989 refers to April 1 1989 - March 31 1990
4. Flows unrelated to reserves

SOURCES:

SA Reserve Bank, *Quarterly Bulletin* , various issues
RSA Department of Finance, *Budget Review 1997*

NOTES

[1] The term 'economic policy reform' is understood in the 1990s to mean the 'neo-liberal approach' or 'Washington consensus' which emphasises fiscal and monetary discipline, outward orientation, liberalisation of product and financial markets, and marketisation of state activity. For a more complete statement of the 'Washington consensus', see J Williamson, "In search of a manual for technopols", in Williamson (ed), *The Political Economy of Policy Reform* (Institute for International Economics, Washington, 1994), 26-28. (Williamson coined the term 'Washington consensus.')

[2] J Williamson & S Haggard, "The political conditions for economic reform" in Williamson (ed, 1994). See also S Haggard & RR Kaufman, *The Political Economy of Democratic Transitions* (Princeton UP, Princeton, 1995), especially chapter 5.

[3] This argument is not surprising: the (usually) implicit assumption in the competitive general equilibrium model which underlies the policy prescriptions of the 'Washington consensus' is of "a unitary government with a given social welfare function - a benevolent dictatorship". See R Kanbur, "Shadow pricing", in J Eatwell, M Milgate and P Newman (eds), *The New Palgrave: The World of Economics* (WW Norton, New York, 1987, 1991), 647. Note that the presumption in the 'Washington consensus' was not always that the dictatorship should be *benevolent*: "A courageous, ruthless and perhaps undemocratic government is required to ride roughshod over these ... special interest groups", argued Deepak Lal in 1983, at the time a senior economist in the World Bank. Cited in J Toye, "Interest group politics and the implementation of adjustment polices in sub-Saharan Africa", in P Gibbon, Y Bangura & A Ofstad (eds), *Authoritarianism, Democracy and Adjustment: The Politics of Economic Reform in Africa* (Scandinavian Institute for African Studies, 1992), 109.

[4] D Rodrik, "Understanding economic policy reform", *Journal of Economic Literature*, 34 (1), March 1996, 32.

[5] A very useful discussion of these issues is M Naim, "Latin America: The second stage of reform", *Journal of Democracy*, 5(4), October 1994.

[6] A Przeworski et al., "Conclusions", in *Economic Reforms in New Democracies: A Social-Democratic Approach* (Cambridge University Press, Cambridge, 1993).

[7] D Rodrik, "How should structural adjustment programs be designed?", *World Development*, 18(7),1990.

[8] See Pundy Pillay's paper for this project.

[9] On a year-on-year basis. See JH Meijer, "Notes on inflation", *SA Reserve Bank Quarterly Bulletin*, 176, June 1990.

[10] R Dornbusch & S Fischer, "Moderate inflation", *World Bank Economic Review*, 7(1), January 1993. These authors define moderate inflation as 15 - 30% persisting for at least three years, but this is clearly arbitrary.

[11] ***SOURCE??***

[12] B Kahn, "SA exchange rate policy 1979-1991", Centre for the Study of the SA Economy and International Finance (referred to below as CREFSA), *Research Paper No. 7* (LSE, London, June 1992).

[13] Meijer, op. cit. It may be noted that the fiscal deficit actually declined from 5.5% of GDP in 1987 to 1.9% in 1989.

[14] International Monetary Fund, "SA: Staff report for the 1990 Article IV consultation", August 15 1990, 8.

[15] Deputy Governor JH Meijer, "No one loves a central banker", *Financial Mail*, Survey, August 30 1991, 11.

[16] IMF, 1990, op.cit., 8.

[17] See "The Reserve Bank. A survey", Supplement to *Financial Mail*, August 31 1990, and J Lombard, ion *Business Day*, November 11 1990.

[18] In fact, three clauses: numbers 223 -225 of the final Constitution (1996).

[19] S Fischer, "How independent should the central bank be?", *American Economic Review*, 85(2), May 1995, 203.

[20] W Streeck, "Pay restraint without incomes policy: Institutionalised monetarism and industrial unionism in Germany", in R Dore et al. (eds), *The Return to Incomes Policy* (Pinter Publishers, London, 1994), 122-23.

[21] See for example R Parsons, cited in *Financial Mail*, August 1991.

[22] IMF, "South Africa - Staff Report", 1990, 10-11.

[23] CEAS, *The Restructuring of the SA Economy. A Normative Model Approach*, March 1993. Department of Finance, *The key issues in the Normative Economic Model*, March 1993.

[24] The intention was that this would be accompanied by a targeted poverty alleviation scheme which was seen to be less costly to the fiscus.

[25] Interview with Jay Naidoo, *SA Labour Bulletin*, 16(2), October/November 1991, 13.

[26] Cited in E Patel, "New institutions of decision-making: The case of the NEF", in E Patel (ed), *Engine of Development? South Africa's National Economic Forum:* (Juta, Cape Town, 1993), 5.

[27] See for example the interviews with Jay Naidoo, op.cit., and with Sam Shilowa, *SA Labour Bulletin*, 16(3), January 1992. The COSATU Secretariat *Report to the 5th National Congress* (September 1994) confirms the 'lack of interest' in engaging in narrow macroeconomic issues within the tripartite process.

[28] CREFSA, "The SA Budget 1993/94", *Quarterly Report*, May 1993, 9.

[29] See Rashad Cassim's paper to this conference.

[30] NEDLAC, *Report to the Annual Summit*, May 1996, 24. A similar statement is found in the 1997 *Report*.

[31] Rodrik, 1996, 37.

[32] Continuation Lecture, University of Pittsburgh, December 6 1991.

[33] "Economic dispute inside ANC breaks into open on Reserve Bank issue", *Southscan*, November 12 1993.

[34] "Mandela on the record: what the SA business community can expect of and from the ANC", *Finance Week*, March 31 1994.

[35] *Finance Week*, September 30 1993.

[36] "Statement of economic policies", signed by the TEC and sent to the IMF, November 1993, reproduced in *Business* Day, March 24 1994.

[37] CREFSA, "Trends and developments in the SA balance of payments", *Quarterly Report*, October 1994.

[38] Mark Suzman, "Longing for an economic miracle", **Financial Times**, September 8 1994.

[39] See, for example, A Adelzadeh, "From the RDP to GEAR: The gradual embracing of neo-liberalism in economic policy", *Transformation*, 31, 1996; S Terreblanche, "The long walk from the RDP to GEAR", mimeo, 1997.

[40] Conceived by Derek Keys, not the ANC. See J Blumenfeld, "From icon to scapegoat: The experience of SA's RDP", *Development Policy Review*, 15, 1997, 73.

[41] See Blumenfeld, op. cit., for references.

[42] Alec Erwin, "Financing Mechanisms for the RDP", in *Human Resource Development in the RDP* (Ravan Press, Johannesburg, 1995) 20, 22. See also Jay Naidoo, Minister responsible for the RDP, cited in Patti Waldmeir et al., "Pretoria seeks to calm fears on spending", *Financial Times*, May 20 1994.

[43] See CREFSA, *Quarterly Review*, July 1995 and April 1996.

[44] See "A double whammy", *Financial Mail*, August 30 1996.

[45] SA Reserve Bank, *Annual Economic Report 1996*, 26.

[46] See Naim, op.cit. (footnote 5
).

[47] See "SA's economic strategy wins plaudits", *Sunday Independent*, October 6 1996. One critique of GEAR which starts from its affinities with the 'Washington consensus', is A Adelzadeh, op.cit., 1996.

[48] See Haggard & Kaufman, op.cit. (footnote 2).

[49] H Barkey, When politics matter: Economic stabilisation in Argentina and Israel", *Studies in Comparative International Development*, 29(4), Winter 1994, 45. See also my other paper to the conference for an elaboration of these ideas in the South African context.

[50] *Sunday Times Business Times*, August 17 1997.